DEPARTMENT OF STATE REVENUE

04-20100731.LOF

Letter of Findings: 04-20100731
Sales/Use Tax
For the Years 2007, 2008, and 2009

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ISSUES

I. Sales/Use Tax – Equipment Purchases.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC § 6-2.5-4-2(c); IC § 6-2.5-5-3; IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); General Motors Corp. v. Indiana Dep't of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991); Indiana Dep't of State Revenue v Cave Stone, Inc. 457 N.E2d 520 (Ind. 1983); N. Cent. Indus., Inc. v. Indiana Dep't of Revenue, 790 N.E.2d 198 (Ind. Tax Ct. 2003); Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998); 45 IAC 2.2-5-10; 45 IAC 2.2-5-12(d)(2); 45 IAC 2.2-5-8(g).

Taxpayer argues that its purchases of various items of equipment were not subject to sales/use tax on the ground that the equipment is used in an exempt manner by producing crushed concrete.

II. Sales/Use Tax – Fuel Purchases.

Authority: IC § 6-8.1-5-1(c); 45 IAC 2.2-5-12(a).

Taxpayer maintains that its purchases of fuel were exempt because the fuel is used to produce crushed concrete.

STATEMENT OF FACTS

Taxpayer is an Indiana excavating contractor and contract hauler. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit review resulted in an assessment of additional gross retail (sales/use) tax.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

I. Sales/Use Tax – Equipment Purchases.

DISCUSSION

Sales tax in Indiana is imposed by IC § 6-2.5-2-1, which states:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
>
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Also, a complementary excise tax "known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). An exemption from the use tax is granted for transactions when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

According to the Department's audit report, "[T]axpayer performs a variety of services, such as hauling for hire to deliver materials owned by others, excavation contracts, septic tank repair and clean out, concrete crushing services for other contractors, and other construction work."

The audit concluded that Taxpayer had purchased certain items of equipment for which it had failed to pay sales tax and which were not used in an exempt manner. In particular, Taxpayer contends that its purchase (or rental) of a "Large Crusher" (hereinafter "crusher") and "Volvo Loader" were not subject to tax.

A. Crusher.

The audit found that the rental – and subsequent purchase – of a crusher was not entirely exempt. The audit described the function of the crusher as follows:

> The crusher was used to crush concrete waste from road construction and building demolition into smaller pieces of rock. Primarily, the [T]axpayer moved this equipment to the construction site, where the [T]axpayer crushed the piles of concrete waste supplied by the contractor performing the construction or demolition.... The [T]axpayer also used the crusher in the same capacity at their [Indiana] location on occasion, crushing concrete brought to their facility by the customer.

The audit also noted that, "[T]axpayer billed the customers by the amount crushed, measured by the ton, or billed by the number of hours the crusher was used." Further, the audit report found in part that Taxpayer was providing a service to its customers:

> [T]axpayer did not own any of the materials crushed by this equipment, and operated the equipment at all times. The contractors paying for the crushing service owned the materials. During the audit period, most of

the crushed concrete was used as fill by the contractors in completing construction contracts, like road construction.

Taxpayer contends that the crusher falls within the exemption provided in 45 IAC 2.2-5-10. The Department notes that 45 IAC 2.2-5-10 states in relevant parts:

(a) In general, all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment used in direct production. It does not apply to materials consumed in production or to materials incorporated into the tangible personal property produced. Additionally, the exemption provided in this regulation [45 IAC 2.2] extends to industrial processors. An industrial processor, as defined in IC 6-2.5-4-2, is one who:

(1) acquires tangible personal property owned by another person;

(2) provides industrial processing or servicing, including enameling or plating, on the property; and

(3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

(b) The state gross retail tax will not apply to sales of manufacturing machinery, tools, and equipment which are to be directly used by the purchaser in processing or refining tangible personal property.

(c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.

....

(Emphasis added).

Taxpayer specifically points to IC § 6-2.5-4-2(c) as support for its contention that the crusher is exempt. The statute states in relevant part:

(c) Notwithstanding any provision of this article, a person is not making a retail transaction when he:

(1) acquires tangible personal property owned by another person;

(2) provides industrial processing or servicing, including enameling or plating, on the property; and

(3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

(Emphasis added).

IC § 6-2.5-5-3 states:

(a) For purposes of this section:

(1) the retreading of tires shall be treated as the processing of tangible personal property; and

(2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

(Emphasis added).

As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is "that tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). As the Indiana Tax Court has stated, "In Indiana, it is well-settled that tax exemptions are to be strictly construed against the taxpayer[,]" Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999).

The Department is also aware of the countervailing rule that "a statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dep't of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

The issue is whether Taxpayer falls within the definition of an "industrial processor," "manufacturer," or "miner" because it crushes concrete. Taxpayer explains that its "processing" of the concrete is akin to a mining operation:

[T]he concrete is extracted from the earth, such as stripped from a road, as the beginning of the extraction

process, transported to the crusher location, loaded into the crusher with a front end loader, crushed by the loader by internal combustion of fuel in the engine, resulting in a material that is tangible personal property to be used in a wide assortment of applications and stockpiled by the loader.

Taxpayer also states "that the Contractor ([Taxpayer's] customer) extracts the concrete from its original location (a highway, bridge, etc.) and brings it to the point of crushing."

The activities described above do not constitute mining. This can be seen by examining 45 IAC 2.2-5-12(d)(2), which states regarding mining:

"Direct use in mining" begins with the drilling of the shaft or well or the first removal of overburden in surface mining or quarrying. It ends when the item being mined or extracted has been physically removed from the mine, well, or quarry.

For the sake of clarity, it should be noted that the audit did find that for subsequent years (i.e. years after the audit period) Taxpayer would be using the crusher "in the stone mining process[.]" The audit granted a partial exemption for the crusher based upon the future mining use (Taxpayer purchased a quarry for mining; this future use would bring the crusher within the scope of Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983). In Cave Stone the companies were "engaged in the business of selling sized aggregate stone removed from their respective quarries." Id. at 521). However, it is Taxpayer's non-mining use (years 2007-2009), which is dissimilar to Cave Stone, that is at issue in the protest. And, as will be seen below, the audit was correct that for the years at issue, Taxpayer is providing a service and that "even if the crushing service qualified as processing, the taxpayer does not meet the qualifications to be an industrial processor."

The Department notes that 45 IAC 2.2-5-10(k) provides:

Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change. Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. A processed or refined end product, however, must be substantially different from the component materials used.

(Emphasis added).

Also of importance is N. Cent. Indus., Inc. v. Indiana Dep't of Revenue, 790 N.E.2d 198, 201-02 (Ind. Tax Ct. 2003), where the Indiana Tax Court stated:

North Central does not create a new, marketable product; it merely packages existing fireworks into boxes, then labels and shrink-wraps them. This is not the sort of substantial change or transformation that places the fireworks "in a form, composition, or character different from that in which [they were] acquired." 45 IAC 2.2–5–8(k).

(Emphasis added).

Taxpayer, in the case at hand, in effect argues that its products are substantially changed from the raw materials (viz., waste concrete) that it receives, while the Department's audit found that Taxpayer was engaged in providing a service for its customers.

In Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998), the Indiana Tax Court examined the issue of "the repair and remanufacture of roller bearings." Id. at 797. The Indiana Tax Court analyzed previous case law, and stated in part:

In Mechanics Laundry & Supply, Inc. v. Department of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1994), this Court evaluated whether the laundering of textiles constituted processing in the context of the industrial exemptions. In concluding that it did not, this Court found that the laundering of soiled textiles merely "perpetuate[d] textiles that were produced by others." Id. at 1230 (citing Undercofler v. Macon Linen Serv., Inc., 114 Ga.App. 231, 241, 150 S.E.2d 703, 709 (1966)). See also Indiana Waste Sys. v. Department of State Revenue, 633 N.E.2d 359 (Ind. Tax Ct.1994) (taxpayer not entitled to exemption where taxpayer compressed garbage but did not produce other tangible personal property). Because the taxpayer in Mechanics Laundry produced no new tangible personal property, it was not entitled to the industrial exemption.

Rotation Products, 690 N.E.2d at 799-800. The Indiana Tax Court in Rotation Products set out a four-part test:

The case law reveals three factors germane to this fact-sensitive inquiry. The first is an adaptation of the requirement of a substantially different end product: the substantiality and complexity of the work done on the existing article and the physical changes to the existing article, including the addition of new parts. The other two factors derive from the observations of the courts dealing with this issue: a comparison of the article's value before and after the work, and how favorably the performance of the remanufactured article compares with the performance of newly manufactured articles of its kind. Additionally, this Court concludes that another factor is applicable to this inquiry: whether the work performed was contemplated as a normal part of the life cycle of the existing article. This additional factor will prevent work that merely perpetuates existing

products from qualifying for an industrial exemption.

Id. at 802-803 (internal footnotes omitted).

In reviewing the various authorities cited above, it is not possible to conclude that the crushed concrete has undergone a "substantial change" (See 45 IAC 2.2-5-10(k)) or to refute the audit's conclusion that the "concrete is essentially crushed into small pieces." Keeping in mind that Taxpayer bears the burden of demonstrating the proposed assessment is wrong, that the exemption statutes are "strictly construed" against exemption, and that a weighing of the factors above does not support Taxpayer's argument, the Department is unable to agree that the crushed concrete meets the requirements necessary to sustain Taxpayer's protest.

B. Volvo Loader.

Taxpayer purchased a Volvo Loader. The Department's audit found that the Volvo Loader was subject to sales/use tax. As described in the audit report:

The loader is not performing any exempt operations; it is simply loading the concrete into the crusher.

Taxpayer maintains that the Volvo Loader is an "integral part of the process" and that "[w]ithout the loader, the crusher is useless and cannot perform the process." However, at the outset it should be noted that 45 IAC 2.2-5-8(g) states in relevant part:

> The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Taxpayer's argument depends on whether or not Taxpayer is occupationally engaged as an industrial processor producing a product which has undergone a "substantial change." See IC § 6-2.5-5-3(b); 45 IAC 2.2-5-10(k). Since the Department has concluded that Taxpayer's crushing waste concrete from highways and bridges does not fall within the statutory exemption, Taxpayer's argument must necessarily fail. In addition, the audit pointed out that loading the waste concrete into the crusher is best categorized as a "pre-production activity" described in 45 IAC 2.2-5-10(f)(1). ("Tangible personal property used for moving raw materials to the plant prior to entrance into the production process is taxable.").

FINDING

Taxpayer's protest of the Crusher and Volvo Loader are respectfully denied.

II. Sales/Use Tax – Fuel Purchases.

DISCUSSION

Taxpayer purchased diesel fuel without paying Indiana sales or use tax. Taxpayer maintains that "the fuel is used to operate the crusher and the loader which is an integral part of the process, be it manufacturing, industrial processing, or extraction." Taxpayer maintains that the purchase of the fuel is exempt pursuant to 45 IAC 2.2-5-12(a), which states as follows:

> The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.
>
> (Emphasis added).

As discussed in Part I above, the Department is unable to agree that Taxpayer is either "manufacturing, processing, refining, or mining." As such, Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of establishing that the original assessment was incorrect. The audit correctly concluded that the purchase of the diesel fuel was subject to sales/use tax.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's protest is denied in all respects.

Posted: 05/30/2012 by Legislative Services Agency
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